

Bond Market Review

April 20, 2010

How to Train your Dragon

Those that have followed the **Bond Market Review** know that we follow interest rates, currencies, other markets, and major global and domestic stock indices, but rarely mention individual companies and certainly make no buy or sell recommendations on any of them. We leave that daunting task to equity analysts. That being said, it's impossible to cover the bond market news for the past week without reporting that on Friday morning Goldman Sachs Group Inc. was sued by the Securities and Exchange Commission for fraud stemming from their part in creating collateralized debt obligations (CDOs) that were a major part of the financial crisis. The CDOs were linked to subprime mortgages that were created and sold in early 2007. It was during that time that the housing market was failing, and the charges stated that Goldman failed to disclose that a hedge fund run by Paulson & Company was allowed to select the underlying securities (for the CDOs) and then bet against them. The turbulence in the markets was heightened as Goldman is the most profitable firm in Wall Street history. They are major contributors to political campaigns, and former Treasury Secretaries Robert Rubin and Hank Paulson (not with Paulson & Co.) were former CEOs with Goldman. Other ex-Goldman employees work with the administration. No doubt the markets know this and that added to the volatility. Nevertheless, even though Goldman's stock traded over 15% lower on the news, and the Dow lost over 125 points, the market has snapped back over the past few days. Goldman Sachs denied the SEC allegations as "*completely unfounded in law and fact.*"

Eyjafjallajökull

Just because our spellchecker didn't recognize the Icelandic volcano, doesn't mean it doesn't exist, and it certainly made its presence known in a big way. Volcanoes spew forth from time to time and, besides making a mess and shutting down flights, they often contribute to a cooling trend (as if we need one following this tough winter). Tonight some airports reopened, but the cost to airlines and stranded passengers was very high. (Under 'Cap and Trade' Iceland would owe some serious fines!) It's amazing the Dow Transports were 3.06% higher last week given volcano-driven losses in the airline sector. If the Volcano and SEC charges against a major Wall Street firm fail to bring down this stock market, what will? As we've said, April is typically a good month for stocks, and this one is no exception.

Looking Ahead

- Bond yields should trade sideways to higher into late April and then fall into late May.
- We continue to expect further weakness in the economy. Stocks could have tradable low in late May.
- We expect the FOMC to leave rates unchanged at their meeting next Wednesday (04/28) at 2:15 EDT.

Someone had to say it!

While the concept seems simple enough, and we individually have to manage our finances with a modicum of balance (which rising taxes will make more difficult), Congress certainly doesn't get it. Thus, it was refreshing to hear a sound voice of reason as FRB Dallas President Richard Fisher said he'd like to see the government come up with a plan to restore fiscal balance and spoke out against the monetization of our debt. Balance the budget! Of course, we'd *like* to see the government spend less, but our fear is they won't 'get it' and try to achieve balance by adding a VAT tax and/or other tax hikes. Fisher said: "*Now the pressure is on the fiscal authorities. ... We will not monetize the deficits.*" Anyone in D.C. listening? Every time we raise the debt ceiling we're monetizing the debt, and the printing press is operating nonstop. Newscasters worldwide were attempting to say Eyjafjallajökull (with little success). It will come to a halt years before we ever balance a budget, and unlike the volcano, a 'fiscally responsible' Congress can't be seen on any horizon. (The 'tea party' is more fearful of what *Congress* is spewing!)

Treasuries, Agencies, and MBS

Weakness in the financial sector (and most stock indices) following the announcement of the SEC suit against Goldman Sachs contributed to a further rally in Treasuries as the support at 10-year 4.01% became more important. For the week, Treasury yields fell 1, 5, 10.5, 14.5, 16, 15, 12, and 7 bps for the 6-month, 1, 2, 3, 5, 7, 10, and 30-year sectors. (Roughly 7 bps points of the 10-year rally came on Friday). Through today, yields were higher by 8 bps at 5-years and 3.5 bps at 10-years as stocks appeared to shake off Friday's losses. We're expecting yields to make a high near April 30th, but the window is wider than normal (plus or minus a week). Though that could merely be only a retest of recent highs (10-year 4.01%), there are time-price targets near 4.21% on May 5th. In either case, yields should still fall sharply (as we've said) "*into the end of May*". If so, we would expect to be at (or above) 4.21% by early August (when we're expecting the seasonal trend-change high in yields). MBS spreads were 2 bps better and agencies pulled in by 1 bps at 10-years. Next week, there will be Treasury auctions of 2-year maturities on Tuesday (04/27), 5-year notes on Wednesday (04/28), and 7-year notes on Thursday (04/29).

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<u>04/16/10 Treasury Yield Curve</u>	<u>2-Year: 0.951%</u>	<u>5-Year: 2.466%</u>	<u>10-Year: 3.763%</u>	<u>30-Year: 4.670%</u>
Weekly Yield Change:	-1050	-1587	-1199	-0692%
Support:	1.07/ 1.10/ 1.14/ 1.18%	2.57/ 2.62/ 2.68/ 2.73%	3.82/ 3.89/ 3.93/ 4.01%	4.71/ 4.77/ 4.88/ 4.93%
Targets:	0.97/ 0.93/ 0.86/ 0.81%	2.49/ 2.43/ 2.40/ 2.36%	3.71/ 3.63/ 3.54/ 3.48%	4.60/ 4.54/ 4.49/ 4.40%

Economics

President Obama signed a bill extending \$18 billion in jobless benefits out to June 2nd and petitioned Congress to extend them to year end. The bill subsidizes health insurance purchases for the jobless and blocks scheduled cuts in Medicare payments to doctors. Initial Jobless Claims jumped 24K to 484K and Continuing Claims were 73K higher to 4,639K. Empire Manufacturing rose from 22.86 to 31.86. In February, foreign entities moved \$47.1 billion into longer Treasury maturities while also adding \$9 billion to U.S. holdings. Additionally, while January's data showed outflows of \$33.4 billion, it was revised to only a \$10.2 billion takeout. Industrial Production was up .1% in March and Capacity Utilization was .2% higher to 73.20%. The Philadelphia Fed was 1.3 higher to 20.2. March Building Permits rose 7.54% to 685K and were up 34.05% to last year. Housing Starts were 1.62% higher to 626K and up 20.15% to last year. That helps to explain why NAHB builder optimism jumped 4 points to 19 in April (the biggest pop since last April). University of Michigan Confidence fell from 73.6 to 69.5. March Leading Indicators matched the May 2009 data at 1.4% (which was the highest since late-2001 data – following 9/11).

Wednesday is set for MBA Mortgage Applications (which were off 9.6% last week). Thursday is loaded with Producer Prices (March PPI), jobless claims data, the RPX Composite (metro home prices), Existing Home Sales, and the House Price Index. Friday brings March Durable Goods Orders and New Home Sales. Monday gives us Dallas Fed Manufacturing Activity. Tuesday brings the S&P/CaseShiller Home Price Index, the Richmond Fed Manufacturing Index, Consumer Confidence, and ABC Consumer Confidence (which just fell 3 points to -50). Next Wednesday is set for the FOMC interest-rate policy statement. The Fed still has some concerns and will most likely leave rates unchanged. Fed Chairman Bernanke said high unemployment and weak construction are some of the “*significant restraints*” to growth and restated that the funds rate would likely remain low for an “*extended period*”. However, given better data, the Fed will be under pressure to begin raising rates later this year (unless Unemployment worsens or equities suffer a major setback). Commercial Real Estate also remains as a barrier to full recovery, and even though many Fed members believe the recession is *over*, they will still vote for low rates.

Equities

Even though the S&P traded higher for last 8 out of 9 sessions, Friday's large down day led to the first losing week (albeit marginally so) in the last seven. The SEC charges against major Wall Street firm Goldman Sachs could have been (and still could be) the catalyst for a larger correction, but the market's resilience was clear with the market pressing higher into today. We had expected positive energy through Monday, and observed just that – even with Friday's setback. Though some cycles are pushing down into May 3rd, others still show some positive force into April 27th. Either way, stock cycles are pointing ‘hard down’ from the second week to the end of May. After losing nearly 126 points on Friday, the Dow came within 8 points of retesting last Thursday's high today. For the week, the S&P lost 2.24 points or .19% to 1,192.13, while other indices managed weekly gains. The Dow was higher by 21.31 points or .19% to 11,018.66 and the Nasdaq rose 27.21 points or 1.11% to 2,481.26. The Transports were up a strong 3.06%. Bank stocks slipped 1.01% given Friday's weakness in the financial sector, but they've rallied back 3.69% through today! We are short the S&P at 1,172 and 1,182 as we used targets and were far too early for the cycle. Our buy stops are S&P 1,217 and 1,228 for that trade.

Resistance:	Dow:	11,155/ 11,265/ 11,338/ 11,658	Nasdaq:	2,518/ 2,582/ 2,641/ 2,685	S&P:	1,214/ 1,225/ 1,237/ 1,242
Support:		10,973/ 10,845/ 10,694/ 10,469		2,451/ 2,383/ 2,358/ 2,293		1,183/ 1,175/ 1,161/ 1,150

Other Markets

Crude Oil was up on the week before diving 2.65% on Friday. Crude ended up losing 1.98% for the week and Gold was off 2.14%, but strength in other components (Corn rose 5.28%) left Commodities ahead by a slight .06% for the week. The Dollar lost .37%, but recovered .24% through today – leaving it just above the center of its trading range since February. The Euro rose .02%, but fell .5% into today and the Japanese Yen gained 1.08% before slipping back 1.14% by today's close.

Additional Information is Available on Request

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“However beautiful the strategy, you should occasionally look at the results.” Sir Winston Churchill

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